UNITED STATES DISTRICT COURT

Northern District of California

San Francisco Division

JESSE HELTON,

Plaintiff,

v.

FACTOR 5, INC., et al.,

Defendants.
_____/

No. C 10-04927 SBA

**REPORT AND RECOMMENDATION**

[Re: ECF No. 103]

## INTRODUCTION

Plaintiffs Jesse Helton, Alisha Piccirillo, and Chad Lowe, individually and on behalf of all others similarly situated (collectively, "Plaintiffs") bring this employment class action lawsuit against defendants Factor 5, Inc. and Factor 5, LLC (collectively, "Factor 5") as well as defendants Julien Eggebrecht, Holger Schmidt, and Thomas Engel (collectively, the "Owner Defendants"), the owners of Factor 5, and defendant BluHarvest, LLC a/k/a WhiteHarvest, LLC ("WhiteHarvest"), their new company. Plaintiffs, who are former employees of Factor 5, allege that (1) Factor 5 stopped paying them in November 2008 prior to their being laid off in December 2008 and has not paid them all of their wages due in violation of federal and California law, and (2) Factor 5's owners (Mr. Eggebrecht, Mr. Schmidt, and Mr. Engel) formed a new business (BluHarvest, LLC/WhiteHarvest, LLC) to continue operating the Factor 5 business under the guise of a new name to evade, hinder, and defraud Factor 5's creditors, including Plaintiffs. *See generally* Notice of Removal, Exh. H

(First Amended Class Action Complaint ("FACAC")), ECF No. 1-1 at 67-86.[1] Factor 5 has defaulted, and Plaintiff now move for default judgment against them. Motion for Default Judgment, ECF No. 103. The district court referred Plaintiffs' motion to the undersigned for a report and recommendation. Order of Reference, ECF No. 114. Upon consideration of motion submitted and the record in this case, and in light of the ongoing proceedings among Plaintiff, WhiteHarvest, and the Owner Defendants, the court **RECOMMENDS** that the district court deny without prejudice Plaintiffs' motion.

**STATEMENT**

Plaintiffs filed their original complaint in Marin County Superior Court on January 1, 2009. Notice of Removal, ECF No. 1 Exh. A (Original Complaint) ¶ 1. They filed their First Amended Class Action Complaint on October 13, 2010. FACAC ¶¶ 10-12. In it, Plaintiffs bring the following claims: (1) failure to pay wages during employment in violation of California Labor Code §§ 204 and 206 (against Factor 5 and WhiteHarvest); (2) failure to pay wages at termination in violation of California Labor Code §§ 201(a) and 203 (against Factor 5 and WhiteHarvest); (3) failure to pay accrued vacation in violation of California Labor Code § 227.3 (against Factor 5 and WhiteHarvest); (4) failure to indemnify for employment-related expenses in violation of California Labor Code § 2802 (against Factor 5 and WhiteHarvest); (5) failure to give at least 60 days prior written notice before cessation of operations in violation of California Labor Code § 1401 et seq. (against Factor 5 and WhiteHarvest); (6) failure to pay federal minimum wage in violation of the Federal Labor Standards Act ("FLSA"), 29 U.S.C. § 206 (against all Defendants); (7) failure to pay overtime wages in violation of the FLSA, 29 U.S.C. § 207 (against all Defendants); (8) breach of contract (against all Defendants); (9) engaging in unfair and lawful business practices in violation of California's Unfair Competition Law ("UCL"), Cal. Bus. & Prof. Code § 17200 et seq. (against all Defendants); (10) fraudulent conveyance (against all Defendants); and (11) accounting (against all Defendants). *Id.* ¶¶ 46-115. The court notes that Plaintiffs ask for a judgment against Defendants jointly and severally. *Id.*

[1] Citations are to the Electronic Case File ("ECF") with pin cites to the electronically-generated page numbers at the top of the document.

On October 29, 2010, the Owner Defendants removed the action to federal court, and Factor 5 and WhiteHarvest joined in the removal. Notice of Removal, ECF No. 1; Joinder, ECF No. 7. The Owner Defendants and WhiteHarvest thereafter answered the First Amended Class Action Complaint. Owner Defendants' Answer, ECF No. 3; WhiteHarvest's Answer, ECF No. 15. Factor 5 never answered the First Amended Class Action Complaint, so, upon Plaintiffs' request, the Clerk of the Court entered their default on February 1, 2011. Request for Entry of Default, ECF No. 18; Entry of Default, ECF No. 22.

Now, Plaintiffs have filed two motions, both of which currently are pending. First, on June 18, 2013, Plaintiffs filed a motion for partial judgment in their favor on their two FLSA claims. Motion for Partial Summary Judgment, ECF No. 97. This motion currently is set for hearing on August 27, 2013 before the district court. Stipulation and Order, ECF No. 111. Second, on June 19, 2013, Plaintiffs filed a motion for default judgment against Factor 5. Motion for Default Judgment, ECF No. 103. As described above, Factor 5 is named as a defendant in all of Plaintiffs' claims. The district court subsequently referred Plaintiffs' motion for default judgment to the undersigned for a report and recommendation, Order of Reference, ECF No. 114, and the undersigned held a hearing on the motion on August 15, 2013, 8/15/2013 Minute Entry, ECF No. 120.

## ANALYSIS

### I. SUBJECT MATTER AND PERSONAL JURISDICTION

Before entering default judgment, a court must determine whether it has subject matter jurisdiction over the action and personal jurisdiction over the defendant. *See In re Tuli*, 172 F.3d 707, 712 (9th Cir. 1999). A court must also ensure the adequacy of service on the defendant. *See Timbuktu Educ. v. Alkaraween Islamic Bookstore*, No. C 06–03025 JSW, 2007 WL 1544790, at *2 (N.D. Cal. May 25, 2007). Plaintiffs have established the these three requirements.

#### A. Subject Matter Jurisdiction

Plaintiffs' sixth and seventh claims are for violation of the FLSA—a federal law. Accordingly, the court has federal question jurisdiction over these claims under 28 U.S.C. § 1331. Because the court has federal question jurisdiction over the federal claims, it also has supplemental jurisdiction over the state law claims under 28 U.S.C. § 1367.

**B. Personal Jurisdiction**

Factor 5 does business in California and has its principal place of business in the Northern District of California. FACAC ¶ 9. It also was served with the First Amended Class Action Complaint and engaged in the activities that are the subject of this lawsuit in the Northern District of California. Notice of Removal, ECF No. 1 ¶ 12, Exh. I; FACAC ¶¶ 5, 9. Accordingly, the court has personal jurisdiction over Factor 5. *See, e.g.*, *S.E.C. v. Ross*, 504 F.3d 1130, 1138 (9th Cir. 2007); *Draper v. Coombs*, 792 F.2d 915, 924 (9th Cir. 1986).

**C. Adequacy of Service**

Federal Rule of Civil Procedure 4(h)(1)(B) allows for service in a judicial district of the United States "by delivering a copy of the summons and of the complaint to an officer . . . or any other agent authorized by appointment or by law to receive service of process . . . ." Similarly, Rule 4(h)(1)(A) authorizes service of process on corporations "in the manner prescribed by Rule 4(e)(1) for serving an individual." Rule 4(e)(1) allows for service "following state law for serving a summons in an action brought in courts of general jurisdiction in the state where the district court is located or where service is made." Fed. R. Civ. P. 4(e)(1). Under California law, "[a] summons may be served by personal delivery of a copy of the summons and of the complaint to the person to be served." Cal. Civ. Proc. Code § 415.10. A summons can be served on a corporation by delivering a copy of the summons and of the complaint to the person designated as agent for service of process. Cal. Civ. Proc. Code § 416.10(a). A summons can also be served on a corporation by delivering a copy of the summons and complaint to the president, chief executive officer, or other head of the corporation. Cal. Civ. Proc. Code § 416.10(b). A dissolved corporation can be served by delivering the process to an officer or agent who controls the corporation's assets or an agent upon whom process might be served at the time of dissolution. Cal. Corp. Code § 2011(b).

Here, as noted above, Factor 5 was properly served with the First Amended Class Action Complaint and summons. Notice of Removal, ECF No. 1 ¶ 12, Exh. I. There also is evidence showing that Plaintiffs served their motion for default judgment on Factor 5. *See* Smith Declaration, ECF No. 107 ¶ 5 ("We have served a copy of this application on counsel for the three owners of Factor 5, Defendants Eggebrecht, Schmidt, and Engel. We are unaware of any new lawyer

representing the Factor 5 Defendants since prior counsel (Nixon Peabody) withdrew from representing them.").

## II. DEFAULT JUDGMENT

Under Federal Rule of Civil Procedure 55(b)(2), a plaintiff may apply to the district court for—and the court may grant—a default judgment against a defendant who has failed to plead or otherwise defend an action. *See Draper*, 792 F.2d at 925. Whether to enter a judgment lies within the court's discretion. *Pepsico, Inc. v. Cal. Sec. Cans*, 238 F. Supp. 2d 1172, 1175 (C.D. Cal. 2002). Still, "[a] defendant's default does not automatically entitle the plaintiff to a court-ordered judgment." *Draper* 792 F.2d at 924-25. Default judgments generally are disfavored because "cases should be decided on their merits whenever reasonably possible." *Eitel v. McCool*, 782 F.2d 1470, 1472 (9th Cir. 1986). Where the clerk has already entered default, the court must take as true the factual allegations of the complaint and other competent evidence submitted. *See TeleVideo Sys., Inc. v. Heidenthal*, 826 F.2d 915, 917 (9th Cir. 1987). Where fewer than all defendants have defaulted, the allegations are only true as to the defaulting defendants. *Shanghai Automation Instrument Co., Ltd. v. Kuei*, 194 F. Supp. 2d 995, 1000 (N.D. Cal. 2001).

### A. The *Eitel* Factors Do Not Weigh in Favor of Entry of Default Judgment at this Time

In deciding whether to enter a default judgment, the court should consider: (1) the possibility of prejudice to the plaintiff; (2) the merits of plaintiff's substantive claims; (3) the sufficiency of the complaint; (4) the sum of money at stake in the action; (5) the possibility of a dispute about the material facts; (6) whether the default was due to excusable neglect; and (7) the strong policy underlying the Federal Rules of Civil Procedure favoring decisions on the merits. *Eitel*, 782 F.2d at 1471-72.

#### *1. Possibility of Prejudice to Plaintiffs*

The first *Eitel* factor considers whether the plaintiff would suffer prejudice if default judgment is not entered, and whether such potential prejudice to the plaintiff militates in favor of granting a default judgment. *Craigslist, Inc. v. Naturemarket, Inc.*, 694 F. Supp. 2d 1039, 1054 (N.D. Cal. 2010). As discussed below, given the risk of inconsistent judgments, the court's view is that default judgment is premature, and the recommendation is to deny the motion without prejudice. Thus, the

possibility of prejudice is remote if the district court denies Plaintiffs' motion without prejudice as this court recommends. Indeed, the district court could refer a re-filed motion to the undersigned later so that default judgment can be considered with the benefit of the facts established in the ongoing proceedings among Plaintiffs and the Owner Defendants. Waiting until the end of the case is unlikely to hamper Plaintiffs' ability to collect on such a default judgment.

In sum, there is little possibility of prejudice in denying Plaintiffs' motion for default judgment without prejudice. Thus, the first *Eitel* factor does not favor the entry of default judgment.

***2. Merits and Sufficiency of the Complaint (the Second and Third Eitel Factors)***

Under the second and third *Eitel* factors, the court considers the merits of the plaintiff's substantive claims and the sufficiency of the complaint. *Eitel*, 782 F.2d at 1471-72. After entry of default, well-pleaded factual allegations in the complaint regarding liability are taken as true, except as to damages. *See TeleVideo*, 826 F.2d at 917-18; *DIRECTV, Inc. v. Hoa Huynh*, 503 F.3d 847, 854 (9th Cir. 2007). "However, a defendant is not held to admit facts that are not well-pleaded or to admit conclusions of law." *DIRECTV*, 503 F.3d at 854 (quoting *Nishimatsu Constr. Co. v. Houston Nat'l Bank*, 515 F.2d 1200, 1206 (5th Cir. 1975) (quotation marks omitted)).

Plaintiffs' motion for default judgment fails to substantively address either of these factors. It does not provide the court with the elements of the 11 claims, and it does not apply the facts to the law. Instead, Plaintiffs summarily state that "[b]y virtue of the default, Factor 5 concedes the allegations in the [First Amended Class Action Complaint]." Motion for Default Judgment, ECF No. 103 at 4. But in the Ninth Circuit, only the well-pleaded *factual* allegations are taken as true, not the legal conclusions. *See DIRECTV*, 503 F.3d at 854. In the absence of any argument in support of the motion, and considering that—as discussed below—the recommendation is that the motion should made after the facts are developed—the court declines to independently research whether Haskins has adequately pleaded facts to support the 11 claims alleged against Factor 5. And again, as discussed below, the court finds that the risk of inconsistent judgments would counsel against entering default judgment even if the allegations were sufficiently pleaded.

***3. Possibility of Dispute concerning a Material Fact***

Factor 5 never answered the First Amended Class Action Complaint, so there is no information

available to the court of a material fact disputed by them. WhiteHarvest and the Owner Defendants, however, dispute several of the facts that are likely to be material to this consideration. *See* Owner Defendants' Answer, ECF No. 3; WhiteHarvest's Answer, ECF No. 15. Because Plaintiffs allege that Defendants are jointly and severally liable, it is very likely that facts material to Factor 5's liability will be challenged by WhiteHarvest and the Owner Defendants. Accordingly, this factor weighs against entering default judgment.

***4. Excusable Neglect***

There is no suggestion of excusable neglect. Factor 5 was served with both the First Amended Class Action Complaint and the motion for default judgment. This factor supports entering default judgment.

***5. Sum of Money at Stake in the Action***

When the amount of money at stake in the litigation is substantial or unreasonable, default judgment is discouraged. *See Eitel*, 782 F.2d at 1472 (three-million dollar judgment, considered in light of the parties' dispute as to material facts, supported a decision not to enter summary judgment); *Tragni v. Southern Elec. Inc.*, No. C 09-32 JF, 2009 WL 3052635, at *5 (N.D. Cal. Sept. 22, 2009); *Board of Trustees v. RBS Washington Blvd, LLC*, No. C 09-00660 WHA, 2010 WL 145097, at *3 (N.D. Cal. Jan. 8, 2010) (citing *Eitel*, 782 F.2d at 1472).

Here, Plaintiffs seeks a default judgment of $1,406,168.65. *See* Motion for Default Judgment, ECF No. 103 at 6-10 (adding subtotals). The court does not consider the amounts requested to be inherently unreasonable, but finds that they are unreasonably large to award based on the scant information provided. On this record and at this time, therefore, the court finds that this factor does not support a default judgment.

***6. Strong Policy in Federal Rules Favoring Decisions on the Merits***

"Cases should be decided upon their merits whenever reasonably possible." *Eitel*, 782 F.2d at 1472. On its own, this factor is not dispositive, *see PepsiCo, Inc.*, 238 F. Supp. 2d at 1177, but in combination with the other factors previously discussed, it advises against granting default judgment in this case.

**B. The *Eitel* Factors Support Denying the Motion for Default Judgment**

In summary, on this record, only the absence of excusable neglect supports granting the motion for default judgment. At this time, even if Plaintiffs were to demonstrate the merits and sufficiency of the complaint, the *Eitel* factors would still advise against granting the motion for default judgment. If Plaintiffs were to move for default judgment upon a more detailed evidentiary record at the conclusion of litigation, however, the court's analysis likely would be different. Accordingly, the undersigned recommends the district court deny the motion for default judgment without prejudice.

**III. THE RISK OF INCONSISTENT JUDGMENTS SUPPORTS DENYING THE MOTION**

Because the Owner Defendants and WhiteHarvest answered the First Amended Class Action Complaint and are not in default, the court's ability to provide a report and recommendation about whether to enter judgment against Factor 5 may be limited by Federal Rule of Civil Procedure 54(b). That rule states that "when multiple parties are involved, the court may direct entry of a final judgment as to one or more, but fewer than all . . . parties only if the court determines that there is no just reason for delay." Fed. R. Civ. P. 54(b); *see Curtiss–Wright Corp. v. Gen. Elec. Co.*, 446 U.S. 1, 8 (1980) (noting that the court has discretion to enter a default judgment as to fewer than all defendants).

Even where the factors listed in *Eitel* suggest there is no just reason for delay, the Supreme Court has cautioned that the court should not enter a default judgment which is, or is likely to be inconsistent with a judgment on the merits as to any answering defendants. *See Frow v. De La Vega*, 82 U.S. 552 (1872). As the Ninth Circuit has explained, *Frow* stands for the proposition that "where a complaint alleges that defendants are jointly liable and one of them defaults, judgment should not be entered against the defaulting defendant until the matter has been adjudicated with regard to all defendants." *In re First T.D. & Invest., Inc.*, 253 F.3d 520, 532 (9th Cir. 2001). If the answering defendants prevail, then the action should be dismissed against both answering and defaulting defendants. *Id.* The Ninth Circuit has extended the applicability of this rule beyond pure joint liability cases, and held that default judgments should not be entered against a defaulting defendant if there are non-defaulting defendants "who are similarly situated, even if not jointly and severally liable" where necessary to avoid an inconsistent result. *Id.*

As Judge Chen explained in a well-reasoned Report and Recommendation interpreting this line of cases, "*Frow*'s applicability turns not on labels such as 'joint liability' or 'joint and several liability,' but rather on the key question of whether under the theory of the complaint, liability of all the defendants must be uniform. Where *Frow* applies, it would be an abuse of discretion to enter a default judgment against some but not all defendants prior to adjudication of the claims against answering defendants." *Shanghai Automation Instr. Co. v. Kuei*, 194 F. Supp. 2d 995, 1008 (N.D. Cal. 2001) (citations omitted).

In the present case, there is a serious risk of inconsistent judgments. Plaintiffs have alleged that Defendants all are jointly and severally liable for the 11 claims alleged in the First Amended Class Action Complaint. FACAC ¶¶ 46-115. Indeed, in their motion for default judgment Plaintiffs seek damages on their California Labor Code claims against Factor 5, *see* Motion for Default Judgment, ECF No. 103 at 6-7, yet they also seek damages on these claims against WhiteHarvest, *see* FACAC ¶¶ 46-75, and the claims against WhiteHarvest are still live and disputed. Plaintiffs also seek liquidated damages from Factor 5 on their sixth claim for failure to pay federal minimum wage in violation of the FLSA, *see* Motion for Default Judgment, ECF No. 103 at 7-8, yet in their motion for partial summary judgment against the Owner Defendants, Plaintiffs ask for the same damages on the same claim, *see* Motion for Partial Summary Judgment, ECF No. 103 at 7-8. In such a posture, the court finds that *Frow* applies and that there is "just reason for delay" of entry of judgment as to Factor 5 under Rule 54(b).

The court discussed this issue with Plaintiffs' counsel at the hearing on the motion, and he acknowledged that the concern is fair. The court therefore recommends that the district court deny without prejudice Plaintiffs' motion for default judgment and allowing them to renew it at the conclusion of the case on the merits against WhiteHarvest and the Owner Defendants. This matter can be considered already referred to the undersigned and can be noticed for hearing directly on the undersigned's calendar.

## CONCLUSION

For the reasons stated above, the court **RECOMMENDS** that the district court deny without prejudice Plaintiffs' motion for default judgment against Factor 5.

Any party may file objections to this Report and Recommendation with the district judge within fourteen days after being served with a copy. *See* 28 U.S.C. § 636(b)(1); Fed. R. Civ. P. 72(b); N.D. Cal. Civ. L.R. 72. Failure to file an objection may waive the right to review of the issue in the district court.

The court **ORDERS** Plaintiffs to serve a copy of this report and recommendation on Factor 5.

**IT IS SO ORDERED.**

Dated: August 15, 2013

LAUREL BEELER
United States Magistrate Judge